an equipment market in which the major ILECs have acquired more of their switching capacity at new equipment prices in recent years.

The DTE appears to suggest that the "instantaneous" reconstruction of every local telephone network in the United States would create capacity shortages and bottlenecks among switch vendors, thereby driving up the market clearing prices of switching equipment above current levels. *See* DTE at 320; Phase 4 Decision at 36-37. The assumption that much or all of the local switching capacity in the United States would have to be resupplied "instantaneously" from existing switch vendors, without any increase in their current inventories or manufacturing capacity, would be the death knell of any forward-looking standard. Nothing in the *Local Competition Order* or anywhere else supports the inclusion of such a "rush job" premium in the cost of switching equipment. To the contrary, adding a "rush job" premium to the cost of switching equipment would violate the fundamental purpose of basing prices on forward-looking costs—to replicate the prices that would result if effective competition already existed in local markets—and would erect an enormous barrier to competitive entry. *See, e.g., Southwestern Bell Tel. Co. v. AT&T Communications of the Southwest, Inc.*, No. A 97-CA-132 SS, slip op. at 24 (W.D. Tex. Aug. 31, 1998). ("There can be little doubt that incremental, forward-looking costs mimic competitive costs-what it would cost efficient companies to enter and compete in a competitive local service market").[14]

[14] The Surface Transportation Board and its predecessor, the Interstate Commerce Commission, have likewise declined to include a rush job premium in applying the stand-alone cost ("SAC") test, the cost standard used to set maximum rates for market dominant traffic on railroads. In several major cases in the 1980s and 1990s, the railroads argued that the hypothetical railroad networks hypothesized by the shippers were so large that actually building them would create massive shortages of materials, equipment and labor. These capacity constraints, the railroads argued, warranted a premium price when the shippers' cost study assumed an accelerated construction schedule. The Board rejected this argument on the ground that recognizing these costs would create the equivalent of a competitive barrier to entry, thereby undermining the role

The DTE says that it cannot be faulted for refusing to consider "new" information, even if that information conclusively demonstrates that rates are not cost-based. "[I]n an industry with ever-changing technology and market conditions," the DTE cautions, considering arguments that changed circumstances have made a previously approved "TELRIC analysis obsolete or incorrect" would lead down the "slippery-slope" of continually relitigating rate cases, much as large ships are in need of continual painting. DTE at 333-34 & n. 653. This is a red herring. Although there is a range in which reasonable minds can differ on how often a state commission should reconsider rates in response to changing technologies and market conditions,[15] that issue has no relevance to the DTE's refusal to modify its rates to reflect the switching discounts that Verizon receives.

This, quite simply, was not new information that was the product of intervening technological changes. It was *old* information that Verizon misrepresented and actively concealed during the 1996-97 proceedings. Verizon then falsely claimed that the deeper discounts for switching equipment were available only for analog-to-digital replacements, when, in fact, Verizon knew full well that switch purchasers receive such discounts on all new switch purchases. *See* DTE at 333 n.653. That has nothing to do with advances in technology or other predictable changes in circumstances during the pendency of a case. Rather, Verizon's misstatements on the issue – the falsity of which Verizon now admits (*id.*) – concerned the price of switching equipment that prevailed at the *outset* of the 1996-97 proceedings. The DTE's

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of the SAC pricing constraint as a surrogate for effective competition. *Coal Trading Co. v. Baltimore & Ohio R. Co.*, 6 I.C.C.2d 361, 412-14 (1990); *West Texas Utils. Co. v. Burlington Northern Railroad Co.*, 1 S.T.B. 638, 671-72 (1996), *aff'd, Burlington Northern Railroad Co. v. STB*, 114 F.3d 206, 214 (D.C. Cir. 1997).

[15] Contrary to the DTE's misstatement (p. 335), AT&T's witness did not "support" a five-year period (and expressly testified that he did not). *See* DTE Dkt. 98-15, p. 62 (Sept. 24, 1998).

failure to provide prompt and timely relief for this serious misconduct obviously devalues the rule of law and encourages similar misconduct in the future.

Next, the DTE argues that the Commission should simply ignore the discount problem because the Commission approved Verizon's Section 271 application in New York despite Verizon's inflated switching prices there. DTE at 340-41. This is ironic. Verizon's 1996 Massachusetts switching rates are radically higher than New York's. Moreover, even if the October 13 filing reduced Massachusetts rates to the current New York levels, the foregoing facts would establish that the October 13 rates cannot themselves be cost-based. The New York rates reflect the same Verizon misstatements to New York regulators, but unlike the Massachusetts rates, the New York rates are subject to true-ups and refunds after the significance of Verizon's misrepresentation is quantified.

3. Loop Costs. In its October 16 comments, WorldCom showed that Verizon's loop costs were also excessive and unreasonable. WorldCom at 28. The DTE, in response, simply asserts that its assumptions concerning the loop lengths and characteristics, fiber/copper mix, and fill factors were reasonable (DTE at 316-19). In fact, as AT&T witness Michael Baranowski explains in his attached declaration, Verizon's loop cost model is little more than an unverifiable black box.[16] To the extent that model can be penetrated at all, it clearly produces inflated cost estimates. *See* Baranowski at 3-9. As Mr. Baranowski explains, the model overstates loop costs by assuming an unreasonably high cost of capital, unrealistically long drop lengths in urban and suburban areas, unreasonably low fill factors for fixed plant, digital loop carrier line cards and

[16] The DTE's claim that "it is possible to find and understand the financial and numerical relationships inherent in the model" (DTE at 316-18) misses the point: the CLECs' grievance goes to the availability or unavailability of the *underlying* data sources. *See* Baranowski at 2-3.

equipment, and excessive spare conduit capacity. Correcting these errors alone is likely to reduce Verizon's loop costs by 30 percent or more. *See* Baranowski at 3.

C. The Showings That Verizon's UNE Prices Foreclose Profitable Entry Provide Compelling Evidence That The UNE Prices Do Not Satisfy The Checklist, That The Massachusetts Market Is Not "Irreversibly Open" To Competition, And That Long Distance Authorization Is Contrary To The Public Interest.

Against this background, it is scarcely surprising that there has been virtually no entry through UNEs in Massachusetts. Verizon's misrepresentations and the DTE's other errors assured that the 1996 rates are radically in excess of the economic costs that Verizon incurs when it uses loop, switching and transport facilities to provide exchange and exchange access services in Massachusetts. A CLEC that purchases the UNE platform in Massachusetts could thus never profitably provide service at rates competitive with Verizon's, for the inflated UNE prices create a price squeeze. *Local Competition*, ¶¶ 635 & 679.

Nonetheless, the DTE contends that it is "irrelevant" that Verizon's network element prices in Massachusetts are far too high to allow profitable entry. In the DTE's view, it does not matter whether alternatives to Verizon's residential services can in fact develop, and it does not matter that BOCs will continue to have intractable monopolies in the vast regions of the country where UNEs are today the only viable means of providing competing exchange and exchange access services. The DTE contends that *any* consideration of the impact of rates on the prospects for real world competition is improperly "results-oriented." That is a remarkable position for a regulatory body whose mission is to protect consumers, and it merely highlights just how far the DTE has strayed from the regulatory scheme contemplated by Congress.

Evidence that profitable UNE-based entry is impossible – even after considering all possible revenue sources (including vertical features and intrastate and interstate access revenues

and portable subsidies) – is, in fact, highly probative of both compliance with checklist item two and of the separate public interest determination that the Commission must make. Properly computed forward-looking costs are, by definition, the costs that Verizon incurs in providing the elements of its network to its own retail arm (which then incurs additional retailing and related costs in using the elements to offer exchange, exchange access, and other services). *Local Competition*, ¶ 679. Verizon recovers its network and retailing costs from a variety of sources, including retail local service charges, vertical features charges, intrastate and interstate access charges and subsidies. And there can be no doubt that, when all costs and revenues are considered, Verizon's local services business is quite profitable. Thus, where, as here, the costs that a Verizon competitor incurs using the same network exceed the expected revenues, that is powerful evidence that those UNE prices are not cost-based.

Moreover, Congress plainly *was* "results-oriented" in crafting § 271. Its objective was to bar BOC long distance entry until CLECs had the same ability to offer exchange and exchange access over leased BOC facilities as BOCs have to provide long distance service over resold interexchange carrier lines. Indeed, even if checklist item two could be deemed satisfied by UNE rates that foreclose competition, the Commission has repeatedly recognized that "the public interest analysis is an independent element of the statutory checklist."[17] It requires the Commission "to review the circumstances presented by the application to ensure that no other relevant factors exist that would frustrate the congressional intent that markets be open."[18] As the Justice Department has repeatedly stated, entry cannot be in the public interest unless local markets are "irreversibly open." Verizon's pricing of UNEs at levels which preclude

[17] *SBC Texas*, ¶ 417; *BA New York*, ¶ 423.

[18] *BA New York*, ¶ 423.

competitive UNE-based entry plainly means that residential markets in Massachusetts are not "irreversibly open."

In short, evidence that competition is impossible at prevailing rates is therefore relevant not only to checklist item two but to the Commission's separate public interest determination.[19] Indeed, it is difficult to understand how the Commission could make a finding that it would be in the public interest to grant a BOC long distance relief – and thereby remove the only meaningful incentive that BOC would have to promote residential competition – at a time when the BOC's UNEs are priced at a level that forecloses broad-based residential competition. It cannot be in the public interest to condone a result that defeats the fundamental purpose of section 271 – using the carrot of 271 relief to achieve competition in both business *and* residential local exchange and exchange access markets.

Recognizing as much, the DTE again sets up a straw man, "urg[ing] the FCC to very carefully consider the ramifications of requiring a specified margin between UNE-P rates (which are cost-based) and expected retail revenues (which are usually derived from revenues that are not cost-based)." DTE at 339 n. 665. No one is suggesting that the Commission do any such thing. Rather, AT&T urges the Commission to look at all the streams of revenue available to both LECs and purchasers of UNEs and to recognize that where, as here, UNE prices make entry unprofitable by a wide margin, that is powerful evidence not only that UNE prices are not appropriately cost-based and warrant a hard look, but that long distance authorization is not in the public interest.

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[19] In its *BA New York* Order, the Commission noted that – although competition was limited in some areas in New York – commenters had failed to "link these market facts to any sin of omission or commission by Bell Atlantic." *Id.* ¶ 427. In Massachusetts, the fact that there has been virtually no use of UNEs to provide residential service is directly attributable to Verizon's excessive UNE-P rates. *See* DOJ Eval. at 19.

II. THE NEW RATES FILED AND APPROVED ON OCTOBER 13, 2000, DO NOT COMPLY WITH SECTION 271.

Three weeks after filing its application, Verizon filed – and the DTE simultaneously approved – new rates for unbundled local switching and transport. *See* DTE at 329. These rates are lower than those the DTE previously approved and still defends as TELRIC-compliant. *Id.* at 343. The DTE concedes that the rates in this new tariff "are not identical to the switching, transport, and port costs currently in effect for VZ-NY, due to differences in rate structure," but nevertheless alleges that "the resulting switching, transport, and port costs for CLECs are virtually identical to those same costs for New York." *Id.* Solely on this basis, and without citation to any supporting data, analysis, or evidence, the DTE summarily asserts that any defect in the original UNE rates is cured by the eleventh-hour importation of New York-derived switching and transport rates. *Id.*

The DTE is mistaken. First, Verizon's Massachusetts UNE rates, even as partly modified by the new switching and transport rates, are not and cannot be found to be TELRIC-compliant for four independent reasons: (1) the terms on which they were approved in New York are not present here; (2) the changes do not cure all of the defects in Verizon's Massachusetts rates; (3) the new rates are unsupported by any cost study or other data needed to support a finding of TELRIC compliance; and (4) the inadequate margins the new rates provide for UNE-based entry. Verizon's new UNE rates thus do not support a finding of checklist compliance.

Second, quite apart from checklist compliance, Verizon's application cannot be approved as in the public interest. Verizon's decision to keep obviously unlawful, competition-preventing UNE rates in place for over three years is a classic abuse of its monopoly power that foreclosed UNE-based residential competition throughout that period. Even if TELRIC-compliant rates had been put in effect shortly before the application were filed, it would be many months (at a

minimum) before CLECs could be in a position to offer UNE-P based service throughout Massachusetts. In the interim, Verizon would have the very illegitimate advantages that § 271 was intended to deny BOCs. Thus, even if the October 13 rates were fully adequate, the Commission must deny Verizon's application both to prevent that violation of Congress's purposes and to deter other BOCs from similarly imposing unlawful impediments to competitive entry until even after the time they file their section 271 applications.

A. The Newly Modified Switching and Transport Rates Do Not Satisfy The TELRIC Standard

The premise of the DTE's endorsement of the New York-derived switching and transport rates is that, because the FCC approved these rates in the New York application, they must be approved here. DTE at 343. That premise is false. In approving the New York UNE rates, the Commission "stress[ed] that we place great weight on the New York Commission's active review and modification of Bell Atlantic's proposed unbundled network element prices, its commitment to TELRIC-based rates, and its detailed supporting comments concerning its extensive, multi-phased network elements rate case, as discussed below." *BA New York*, ¶ 238. None of the critical factors that expressly led the Commission to approve the New York UNE rates is present here.

First, the DTE has not committed in the future to address the obvious defects in the very switching rates that it so promptly approved here. The New York switching rates were set in reliance on testimony by Bell Atlantic "that it did not receive large switch discounts from its vendors." *BA New York*, ¶ 247. That testimony was false, as proven by AT&T's "new evidence" of subsequent admissions from Bell Atlantic. *Id.* For this reason, the New York Commission conceded – and this Commission acknowledged – that the New York switching prices "may be adjusted in the future to account for [this] newly adduced evidence." *Id.* ¶ 247.

And in fact, the New York PSC is now reassessing Verizon's switching prices in a currently active pricing proceeding. Most significantly, the New York PSC is committed to ordering refunds in the event it concludes that Verizon's previously approved switching prices are too high. *See* NYPSC, Order Denying Motion to Reopen Phase I and Instituting New Proceeding, at 12 (Case No. 95-C-0657 *et seq.*, Sept. 30, 1998) ("[E]ven though all other Phase I rates are planned to be made permanent, switching rates are planned to be kept temporary, subject to future refund or reparation.").

The Massachusetts DTE has made no comparable commitment. In essence, the DTE has ordered permanent rates, without a cost study, based on another state's temporary rates that are currently under review in that state and that will, in all likelihood, shortly be superseded as not TELRIC-compliant in New York. Indeed, despite the NYPSC's actions, the DTE's comments reject any need to reflect the higher discounts Verizon concededly receives on new switches, but concealed from both agencies. There is thus no basis upon which the Commission can have confidence that the Massachusetts DTE, like the NYPSC, will actively review and modify Verizon's switching prices to remedy obvious methodological defects such as the failure to account for new switch discounts. *See* WorldCom at 34-38.

In short, the New York rates that Verizon imported are not the New York rates that CLECs eventually will pay. The assurances that this Commission had in New York that competitors would ultimately pay only TELRIC-compliant switching prices are entirely lacking here.

Second, the Commission cannot place any weight here on the Massachusetts DTE's "commitment to TELRIC based rates" or to its "detailed supporting comments." *BA New York*, ¶ 238. As shown in Part I, *supra*, the DTE's earnest but factually unsupported defense of its

obviously non-TELRIC rates vividly illustrates its failure to understand and rigorously apply TELRIC principles. In this respect, as well, the DTE's performance stands in stark contrast to that of the New York PSC. The New York PSC, for example, "engaged in extensive fact-finding in its rate case," with the result that numerous UNE prices, including "Bell Atlantic's switching prices," were "greatly reduced" from the levels that Bell Atlantic had proposed. *BA New York*, ¶ 246. By contrast, as WorldCom has previously shown, the DTE adopted – without material adjustment – most of the significant rates that Verizon proposed. WorldCom at 9-37.

Indeed, nothing could be more emblematic of the DTE's unwillingness to engage in a rigorous evaluation of whether Verizon's rates comply with TELRIC than the DTE's decision to approve Verizon's new rates on the same day they were proposed – without seeking supporting documentation, hearing, or comment. In sharp contrast, the DOJ made plain that it could not venture an opinion as to whether the new rates complied with TELRIC given only the "limited information available" to it. DOJ Eval. at 21 n.72. The DTE's decision uncritically to accept the New York rates as TELRIC-compliant is also ironic. The DTE vehemently insists, elsewhere in its comments, that other states' UNE rates could not possibly have any relevance to Massachusetts because Massachusetts may have distinctive factual circumstances. *See* DTE at 336-37. Indeed, the rates in New York were approved in part on grounds that were unique to New York and that were found to justify higher rates there than in other states. *See BA New York*, ¶¶ 248-49. In this regard, the current New York rates are substantially higher than those set in other Verizon states (*e.g.*, Vermont and Pennsylvania) that are, if anything, costlier to serve than Massachusetts. In all events, the DTE patently cannot defend its rejection of lower rates and its reliance on New York rates unless it shows that Massachusetts has the same conditions as New York.

Third, and most fundamentally, the Commission approved the New York application in significant measure because the New York PSC's diligent efforts had created a "well established pro-competitive regulatory environment in New York," and a "thriving market" for local service in which competitors "are able to enter the local market using all three entry paths provided under the Act." *BA New York*, ¶ 13. In particular, DOJ notes that "the use of the UNE-platform accounts for rapid CLEC expansion into the residential market" in New York. DOJ Eval. at 6. The presence of several significant UNE-platform-based competitors in the New York market reflects, in significant measure, the deliberate decision of the New York PSC to set UNE-prices at a level that it believed would be sufficiently low to attract UNE-platform based entry.

In contrast, the Massachusetts DTE candidly professes complete indifference to whether its UNE-approved prices permit competition with Verizon. In the DTE's view, "such a results-oriented analysis has no place in administrative law" and is a "red herring and should be recognized and rejected as such." DTE at 339-40. Because of the DTE's approach, "CLECs have made little use of the UNE-platform in Massachusetts." DOJ Eval. at 6. The lack of any true commitment from the state commission to establish and maintain truly cost-based prices that can sustain competitive entry thus sharply distinguishes this application from New York.

The importance of this shortcoming cannot be overstated. Although the prices set in New York were sufficient to attract UNE-platform-based entry, they may not be sufficient to sustain it. Indeed, there is serious question whether AT&T will be able to continue to offer local service in New York if significant decreases in UNE rates are not soon established. As Verizon's CEO recently stated publicly, Verizon's UNE prices are so high relative to its retail rates that no competitor can offer local service at a competitive price and make money doing so. In particular, Verizon's CEO Ivan Seidenberg gleefully told investment analysts that "leasing [Verizon's

network elements] costs AT&T $22 per residential customer per month," so "whoever is buying [AT&T's] $24.95 [basic local services] product knows they're not making any money on it."[20] As he recognized, because CLECs incur start up systems and marketing costs and operational expenses as well as the cost of UNEs, the New York rates deny competitors the "margins" they need profitably to offer local residential service. *Id.*

The future of broad-based residential competition in New York will therefore depend on the dedication and effectiveness of the New York PSC in hereafter driving down Verizon's inflated rates to a true TELRIC level. Although this Commission expressed confidence in the New York Commission's ability to accomplish that crucial task, the Massachusetts DTE has provided no basis whatsoever for placing any comparable reliance upon it.

B. Even If Verizon's Switching And Transports Rates Now Satisfied TELRIC, Its Loop Rates Do Not.

Verizon's last minute substitution of New York-based switching and transport rates is insufficient to demonstrate TELRIC-compliance for a second, independent reason. Verizon has not changed the other rates that are equally essential to successful UNE-based entry: *e.g.*, the local loop rates. These rates are inflated by the DTE's approval of a cost of capital that is 200 basis points higher than that set by other states in which Verizon operates, and that rest on assumptions other than cost of capital that are plainly incompatible with TELRIC. Further, these rates rest on other inputs that are significantly higher than those used in other Verizon states and that are significantly higher than the loop costs that the Commission established for Massachusetts in its USF proceedings. *See* Baranowski Decl. Critically, the DTE has not

[20] Krause, "Verizon's New York Fight Key To AT&T Challenge," Investor's Business Daily, August 15, 2000, Section A, p. 6.

advanced any Massachusetts-specific facts that could account for such a departure. *See, e.g.*, WorldCom at 30-31.

C. Verizon Has Adduced No Evidence To Overcome The Presumption That Its Rates Are Not Cost Based.

Verizon's new rates cannot be found to be cost-based for yet a third, independent reason. As WorldCom noted in its opening comments, even accounting for the impact of the newly approved rates, the cost of providing service using the UNE-platform in Massachusetts remains too high, as compared to the retail price that Verizon charges for local service, to support competitive entry. *See* WorldCom at 33 n.45; Proferes Decl. at ¶ 44 n. 9. WorldCom has since done a more complete analysis that confirms this fact, and that is being submitted with its Reply Comments. AT&T fully concurs WorldCom's conclusion that profitable entry is not possible in Massachusetts under the October 13 rates.

Contrary to the DTE's claims, the fact that UNE rates are set so high with respect to retail prices that they preclude competitive entry is not a "red herring." Rather, it is compelling proof that the UNE prices are in fact not set in compliance with TELRIC. As the Commission has stated, if TELRIC is properly applied, the resulting rates will reflect the economic costs that the incumbent LECs incur when they use the same facilities to provide local exchange, exchange access, and other services, and allow new entrants to share the LECs' economies of scale. *Local Competition*, ¶ 679. It quite simply is preposterous to suppose that there is any state in the nation where the incumbent LECs are not earning a full economic return (and indeed profiting handsomely) from their provision of interstate and intrastate services over their network facilities. Indeed, neither VZ-MA nor the DTE have made any demonstration that VZ-MA is not earning an adequate profit on local service in Massachusetts.

It follows that where it is the case that CLECs cannot profitably use UNEs to offer their own exchange and exchange access services, it constitutes clear evidence that UNE rates have not been set at their economic cost and that the rates violate TELRIC. Indeed, absent a showing that incumbent LECs enjoy substantial economies of scale in providing retailing functions or that CLECs are required to offer discounts that drive their revenues below cost, proof that margins are insufficient to sustain UNE-based entry should be compelling evidence of the fact that the rates do not satisfy TELRIC. CLEC margin analyses is highly significant – whether presented formally and analytically, as WorldCom as done, or presented "de facto" by the absence of CLEC entry in a state with high UNE rates and concurrent CLEC entry into nearby states with lower UNE rates. In either event, when such an analysis indicates that UNE rates are too high to permit profitable, efficient entry, that alone generally should be sufficient proof that the rates are not TELRIC compliant.

At the very least, this Commission should hold that such proof creates a strong presumption that the UNE rates are not properly TELRIC-based. And that presumption should be rebuttable by the BOC, if at all, *only* by a detailed factual demonstration that both establishes that the UNE-rates are TELRIC compliant and that convincingly explains how, with retail rates so low, the BOC is managing to recover its costs and earn its rate of return. To bless competition-preventing UNE rates as compliant with TELRIC without any supporting cost analysis would be arbitrary and capricious.

For this reason as well, Verizon's last-minute tariff submission cannot possibly provide the Commission with a rational basis for approving the new rates as "cost-based" and compliant with TELRIC. Not only is there no supporting analysis of these new rates from the DTE, but Verizon itself has not even provided the raw material needed to allow this Commission to

conduct that analysis in the first instance. There is simply no factual basis to rebut WorldCom's margin analysis. Given WorldCom's unrebutted evidence that the modified rates in Massachusetts remain too high to support competitive entry, the Commission should conclude that the modified UNE rates are not set at a true TELRIC level.

D. Approval Of The Application Based On The New Rates Is Not In The Public Interest

For the foregoing reasons, Verizon's UNE rates, as modified by its new switching and transport rates, cannot be found TELRIC-compliant and consistent with the competitive checklist. But quite apart from that defect, the belated filing of those new rates is, in itself, an independent and fully sufficient reason for rejecting Verizon's application. Verizon's last-minute substitution of lower rates is an egregiously anticompetitive abuse of its monopoly power. It means that if Verizon's application were granted today, it would be months (at a minimum) before CLECs could offer UNE-P based residential service throughout Massachusetts and that Verizon would have the very advantage in offering packages of local and long distance services that § 271 was enacted to prevent. To prevent this violation and to deter similar BOC abuses in the future, the Commission should make clear that this application would be rejected under the public interest standard even if the new rates had been TELRIC-compliant – which, in this case, they are not.

Part of the problem – but only a relatively small part – is that Verizon waited until one business day before comments were due to file its new rates. Because this is the latest example in a long line of examples of the BOCs' cavalier disregard of this Commission's "complete-when-filed" rule, it nevertheless should not pass without comment. Verizon's contempt for the rule in this particular case has had the unfortunate effect, which the DOJ describes as "regrettable" (DOJ Eval. at 20), of denying the Department the ability to comment on other

parties' assessment of those tardily-filed rates, and to "attempt to assess whether the prices in Verizon's tariff filing are cost-based." DOJ Eval. at 21 n.72.

But in this particular instance, "restarting the clock" would do nothing to address the more fundamental problem with Verizon's belated rate-change. Indeed, the fundamental problem would be precisely the same if Verizon had filed the new rates on the day, the week, or even the month before filing this application.

That is because the level of UNE rates is a crucial determinant of whether CLECs will begin to take the many steps needed to develop and execute a market-entry plan in a particular state. As the DOJ observes, "[t]he most plausible explanation for the limited use of the UNE-platform in Massachusetts appears to be the relatively high prices charged by Verizon for certain unbundled network elements, and there are reasons to suspect that in some cases those prices have not been based on the relevant costs of the network elements." DOJ Eval. at 19 (footnotes omitted).

This problem cannot be fixed overnight. If a state commission sets UNE rates – as DTE has done – at a level far in excess of what would be needed to support competitive entry, then CLECs will simply drop that state to the bottom of their list or remove the state from their list altogether. CLECs will not make the substantial investments in writing and entering software code and taking the other steps required to customize support systems and deploy them so that they will support the provision of residential services in that state. CLECs will not implement the necessary interfaces with the BOC and test them. CLECs will not conduct the market research and related activities that are necessary preludes to broad-based entry. Rather, they will concentrate their entry efforts on other states where UNE rates make local entry economically viable, and put themselves in a position where UNE-based entry in a state like Massachusetts

will be a minimum of many months away even if rates and other conditions change in ways that make entry possible.

In short, while Verizon could alter its UNE rates with a stroke of a pen, CLECs cannot respond with remotely comparable speed. It takes months to develop a business plan for a particular state, to design and engage in market readiness testing, to ensure that all operations support systems and other support processes are operationally ready and capable of supporting a local offer in a new state, and to launch broad-based service.

Verizon – and indeed, all BOCs – are fully aware of this simple fact. Were the Commission to approve this application on the basis of these newly filed rates – whether at the end of the current 90-day period or after some nominal delay for "restarting the clock" – it would effectively send a signal to every BOC that it is open season to deny CLECs any element crucial to market entry until the eve of its section 271 application. The BOC, of course, would have every incentive to do just this. By denying competitors any incentive even to begin developing a business plan, and by maintaining such an unlawful stance right up until the filing of its § 271 application, a BOC immediately gains an enormous advantage that will enable it to perpetuate much, if not all, of its local monopoly even after it has, as a purely formal matter, been deemed to have "opened" its local markets to competition.

The public interest prong of Section 271 review is designed to prevent precisely this sort of anticompetitive gamesmanship. The very inclusion of the public interest test in Section 271 reflects Congress's recognition that, notwithstanding a BOC's demonstration of checklist compliance, other factors could be present that would mean that approval of its application would not be in the public interest.

No more stark illustration of the wisdom of that statutory scheme can be found than this application. Here, Verizon deliberately stonewalled the development of any significant residential competition by ensuring that the UNE-platform is priced so high as to preclude entry. Put another way, Verizon deliberately maintained – in the face of explicit statutory and regulatory commands to the contrary – unlawfully high UNE prices for over three years, thereby barring any significant UNE-based residential competition. It deserves no reward today for that unlawful conduct. Lowering UNE prices at the time of its 271 application is not a good-faith effort to comply with the Act, but a deliberate bait-and-switch. Were this Commission to look the other way and approve this application, the Commission would publicly and unmistakably be rewarding Verizon for effectively and illegally blocking competition for the last three years, and would bestow upon it an overwhelming and wholly undeserved advantage in blocking competition in the years ahead.

III. THE COMMISSION SHOULD DENY THIS APPLICATION AND REAFFIRM ITS COMMITMENT TO ENFORCE TELRIC, AND INDEPENDENTLY REVIEW UNE RATES IN § 271 PROCEEDINGS.

The foregoing analysis establishes that this is – or should be – an easy case. Congress provided that the Commission may not grant a Section 271 application unless and until it finds that the BOC is charging rates that accord with the cost-based requirements of the Act and the Commission's regulations. It did so in order to prevent the BOC from being able to engage in price squeezes that would threaten both long-distance and local competition and to assure that, upon the BOC's entry into long distance, CLECs would have the ability ubiquitously to offer local exchange and exchange access services through UNEs. Verizon cannot show that its Massachusetts rates comply with those requirements. Its application therefore fails to satisfy the checklist and is contrary to the public interest, and must be denied. 47 U.S.C. § 271(d)(3)(A)(i).

Indeed, even if the Commission had discretion to act otherwise and were not statutorily precluded from limiting the terms of the checklist (*see* 47 U.S.C. § 271(d)(4)), it would be irrational, and indefensible public policy, for the Commission to fail to enforce requirements so essential to the prospects for competitive entry as those relating to pricing. This is not, after all, a situation in which a state has successfully fostered a competitive environment and a party is seizing on some technical and peripheral defect in checklist compliance to prevent an otherwise meritorious application from being granted. The story is here far more simple: UNE-based competition is infeasible in Massachusetts because Verizon's prices do not permit it. Moreover, that same obstacle is broadly present in other states as well, where broad-scale competition through UNEs, particularly for residential customers, is likewise infeasible because of excessive prices. It is therefore particularly important to the future of local competition generally that the Commission deny Verizon's application so that BOCs in other states, as well as Verizon in Massachusetts, are encouraged to adjust their prices to lawful levels promptly, and well before they are permitted to enter the long distance market.

AT&T recognizes, however, that others will strenuously resist the suggestion that the Commission should deny a long-distance application on the ground that state-approved rates are unlawful and anticompetitive. Although the Commission has not yet explicitly so stated, it appears from the tenor of the Commission's recent orders in Section 271 and other proceedings that the Commission believes that it should limit its role to exhorting states to adhere to some ill-defined version of forward-looking pricing. These orders also seem to convey the impression that the Commission will take no prescriptive actions that would bind the states, and that it will not even offer opinions on the application of TELRIC in a manner that would constrain the

states' discretion in arbitration proceedings and provide clear grounds for reviewing courts to review and reject state-approved rates that are excessive.

If true, this would represent a dramatic reversal of position. In its *First Report* in the *Local Competition* rulemaking, the Commission asserted not only broad rulemaking authority over rates, but also the authority to specify the requirements of TELRIC in more detail in further proceedings in that docket, in response to petitions for declaratory rulings, in § 208 complaint proceedings, in § 271 proceedings, or in enforcement proceedings under 47 U.S.C. §§ 312, 403 or 501-03. *Local Competition*, ¶¶ 121-130. Further, when the Commission subsequently adopted TELRIC to determine the amounts of explicit universal service support subsidies, it emphasized that the use of the same methodology would eliminate arbitrage opportunities, because universal service support payments and UNE prices would be set on the same basis. *Universal Service*, 12 FCC Rcd. 8716, 8916, ¶ 251 (1997).

Most pertinently still, three years ago, in the subsequent *Ameritech Michigan* order, the Commission set forth in great detail the legal and policy reasons underlying its duty independently to assess – as its "exclusive responsibility" -- whether a BOC applicant's prices comply with the Act and the Commission's regulations. *Ameritech Michigan*, 12 FCC Rcd. at 20695, ¶ 282. The Commission's reasoning was careful, cogent and irrefutable. The Commission explained that it is "require[d]" under Section 271(d) to "determine" that the BOC has fully complied with the checklist before it may grant the BOC long-distance authority, and that the "checklist, in turn, requires the BOC to provide interconnection, unbundled network elements, transport and termination, and resale at prices that are 'in accordance with' Section 252(d)." *Id.* at 20694, ¶ 282 (citing 47 U.S.C. §§ 271(c)(2)(B)(i), (ii), (xiii), (xiv)). Those provisions, the Commission further explained, require that pricing for network elements "be

based on TELRIC principles" and "result in fact in reasonable procompetitive prices," and that the Commission could not and would not approve an application simply because the state uses the TELRIC "label." *Id.* at 20698, ¶ 290. A BOC is therefore required "to include in its application detailed information concerning how unbundled network element prices were derived" so that the Commission can "know the basis for the prices submitted by the BOC in the application" and determine for itself, and on the record, that the BOC's prices are TELRIC-compliant. *Id.* at 20699, ¶ 294.

These legal requirements represent "sound policy," the Commission also explained, because "[d]etermining cost-based rates has profound implications for the advent of competition in the local markets and for competition in the long-distance market." *Id.* at 20697, ¶ 287. The "purpose" of the checklist is "to provide a gauge for whether the local markets are open to competition," and the Commission therefore "cannot conclude that the checklist has been met" if network element prices "do not permit efficient entry." *Id.* The Commission expressly recognized that "allowing a BOC into the in-region interLATA market in one of its states when that BOC is charging noncompetitive prices for interconnection or unbundled network elements in that state could give that BOC an unfair advantage in the provision of long distance or bundled services." *Id.* Indeed, for all these reasons, the Commission stated that even if it did not have the responsibility independently to assess prices under the checklist, the enormous importance of pricing for achievement of the Act's objectives would require that it then assess the prices "in our public interest inquiry under section 271(d)(3)(C)." *Id.* at ¶ 288.

The BOCs and the states claimed that this reasoning was a legal subterfuge designed by the Commission to circumvent the Eighth Circuit's earlier holding (from 1997) that the Commission lacked rulemaking authority over UNE pricing generally. The Eighth Circuit

agreed, and issued a writ of mandamus requiring the FCC to defer to state pricing decisions in future Section 271 proceedings. *Iowa Utils. Bd.* v. *FCC*, 135 F.3d 535 (8th Cir. 1998). The Commission refuted this claim, both in its briefs before the Eighth Circuit and in a subsequent petition for certiorari before the Supreme Court. The Commission explained that its exclusive statutory duties under Section 271 required an independent review of BOC prices regardless of whether the Eighth Circuit had been correct in its interpretation of Sections 251 and 252. *See* Respondents' Opposition to Petitions for Issuance and Enforcement of the Mandate, *Iowa Utilities Board* v. *FCC*, No. 96-3321 (8th Cir., Sept. 29, 1997); FCC's Petition for a Writ of Certiorari, *FCC* v. *Iowa Utilities Board*, No. 97-1519 (U.S. March, 1998). The Supreme Court later granted the Commission's (and AT&T's) petitions and vacated the Eighth Circuit's writ. *United States v. Iowa Utilities Board*, 525 U.S. 1133 (1999). The Supreme Court did so after holding that the Commission has also had independent jurisdiction to adopt rules that bind states when they arbitrate interconnection agreements. *AT&T Corp.* v. *Iowa Utilities Board*, 525 U.S. 366 (1999).

However, although the Commission first articulated the principle as a matter of sound public policy, and then won it as a legal matter in the Supreme Court, CLECs fear and the BOCs believe that the Commission has become indifferent to its actual implementation. In particular, CLECs fear – and the BOCs hope – that the Commission believes that the benefits of enforcing the Act's requirements rigorously are not worth the political costs of irritating any state commissions, like the DTE, which mistakenly believe that as a matter of "federalism" (DTE at 336), it is their prerogative to determine whether and to what extent UNE prices should be set at levels that allow competition. Whatever the reason, once the Supreme Court reestablished the Commission's authority to adopt pricing rules under Sections 251 and 252(d), the Commission

appears to have lost interest in enforcing the pricing requirements of the Act either in Section 271 proceedings or in proceedings under other provisions of the Act. *See, e.g., AT&T* v. *Bell Atlantic Corp.*, File No. E-98-05 (Aug. 18, 2000) (declining to enforce merger condition requiring forward-looking pricing on the ground that the Supreme Court's decision in *Iowa Utilities Board* eliminates any reason to do so).

Not surprisingly, the BOCs have been quick and ruthless in exploiting this apparent change in the Commission's attitude. For example, Verizon plainly believes that *Ameritech Michigan* has become a Potemkin standard that will not be enforced. Otherwise, Verizon would not have submitted this application while it was charging such anticompetitive rates. Nor would it have changed those rates during the application's pendency without providing any support or cost-justification for the new levels, and without even addressing the devastating foreclosure of entry that its adherence to the prior rates had produced.

At the same time, none of the elements of the Commission's *Ameritech Michigan* analysis have ever been or could be refuted. The statutory provisions on which the Commission relied in acknowledging its responsibility to engage in an independent assessment of the rates have not been amended, and their meaning is plain. And their importance is undeniable, for in order to accomplish the objectives of the Act it remains "critical that prices for these inputs be set at levels that encourage efficient market entry." *Ameritech Michigan*, 12 FCC Rcd. at 20697, ¶ 289. Indeed, if anything, after three more years of virtually no UNE-based mass market entry, the centrality of pricing to the success or failure of the Act has become even more manifest.

Opponents of Commission enforcement of its pricing requirements have no effective response to these fundamental legal and policy principles. Their principal arguments fall into three categories. They contend that (1) independent Commission review of prices would be

contrary to the values of federalism "that imbue the Act," DTE at 336, (2) Section 252(e)(6) proceedings should be relied upon to enforce pricing requirements instead, and (3) it would be more effective or appropriate for the Commission to improve BOC prices by engaging in workshops and other such collaborative efforts aimed at persuading state commissions to better exercise their authority, rather than actually exercising the Commission's own authority. Each of these arguments is baseless.

First, "federalism" was the organizing principle of telecommunications regulation *before* 1996, when local service was governed by state policy and only interstate service was governed by national policy. The 1996 Act changed that by "tak[ing] the regulation of local telecommunications competition away from the States." *AT&T* v. *Iowa Utils. Bd.*, 525 U.S. 366, 378 n.6. The Act established new *national* requirements applicable to local exchange service and the facilities used to provide it, and conferred on the FCC comprehensive authority to interpret and enforce those requirements. The Supreme Court held in *Iowa Utilities Board* that Section 201(b) gives the Commission rulemaking authority to implement all of the local competition provisions of the Act, and makes no distinction between its pricing and non-pricing requirements. Indeed, claims about federalism are particularly misplaced in the context of Section 271 proceedings, for these proceedings decide a question over which states have *never* had authority – whether BOCs will be permitted to provide predominantly interstate long-distance services.

This does not mean, of course, that prices will not "vary[] . . . from state to state." *Ameritech Michigan*, 12 FCC Rcd. at 20699, ¶ 291. They will, because of "differences in terrain, population density, . . . labor costs," and other state-specific conditions. *Id.* But that does not mean that states may improperly base rate differences on different *policies*. Rather, the

Commission must "apply[] uniform principles to give content to the cost-based standard in the competitive checklist for each state-by-state section 271 application." *Id.* at 20697, ¶ 286. A state commission therefore cannot simply assert that it is entitled to approve rates at significant variance from those of neighboring states or the Commission's USF determinations, as the DTE has done in this proceeding (at 336). It must identify and persuasively explain the specific differences between its state and others that it believes justify such variations. Conversely if a state relies upon rates established by other states, it must explain why such reliance is reasonable.

Nor can the availability of federal court review of state commission arbitration decisions under Section 252(e)(6) excuse the Commission from its responsibility to determine checklist compliance under Section 271. Congress required Commission findings of checklist compliance as a prerequisite to a grant of long-distance authority *notwithstanding* the availability of Section 252 actions in federal court, and with good reason. The two types of proceedings take place at different times, involve different evidence, and perform different functions. A court reviewing an arbitration decision is generally looking at the record that was compiled before the state commission at the time of the state commission's decision. The Section 271 determination, by contrast, may take place years later, and must be based on the conditions then prevailing. It must therefore take into account not only intervening developments but also any additional evidence that is then placed in the record.

More fundamentally, the Commission has vastly greater expertise and institutional capacity on ratemaking matters than federal courts. That is undoubtedly why the states in *Iowa Utilities Board* repeatedly and incongruously invoked "federalism" in seeking to invalidate the Commission's rules even while recognizing that, if they prevailed, they would remain subject to federal court review under the federal Act. That is also why states similarly argued (ultimately